

Katz Feb 71
CJB 3-18-92



Bennett E. Katz
Counsel

MEMORANDUM

TO: THE VISA U.S.A. BOARD OF DIRECTORS
FROM: Bennett Katz
DATE: April 23, 1991
SUBJECT: MEMBERSHIP

Pursuant to your request, I have enclosed a copy of the overheads presented at last Friday's Board meeting. These documents are marked confidential and privileged. Please do not distribute these documents as it is important to maintain the attorney-client privilege.

BRK:eb

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GOVERNMENT
DEPOSITION
EXHIBIT
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DEPOSITION
EXHIBIT
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POWAR

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THREE OPTIONS

1. OPEN MEMBERSHIP TO ALL REGULATED FINANCIAL INSTITUTIONS REGARDLESS OF OWNERSHIP, EXCEPT SEARS AND AMERICAN EXPRESS (MASTERCARD POSITION)
2. CLOSE MEMBERSHIP TO REGULATED FINANCIAL INSTITUTIONS OWNED BY NON-BANKS (MORATORIUM)
3. CLOSE MEMBERSHIP TO REGULATED FINANCIAL INSTITUTIONS OWNED BY NON-BANKS AND ROLL BACK ISSUANCE DUALITY

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RESEARCH UNDERTAKEN

1. VISA COMMISSIONED SURVEY OF AT&T CARDHOLDERS
2. ANALYSIS OF MEMBER SOLICITATION RESULTS
3. PSI ANNUAL INDUSTRY SURVEY
4. ANALYSIS OF POTENTIAL ENTRANTS
5. AT&T EXPERIENCE TO DATE

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VISA'S POSITION

- OPEN MEMBERSHIP
- MODIFY AFFINITY RULES TO MATCH MASTERCARD

OR

- CLOSE MEMBERSHIP ON ISSUANCE AND ROLL BACK DUALITY ON ISSUANCE

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PRINCIPLES OF NON-DUALITY

1. NO FURTHER CARDHOLDER SOLICITATIONS OF COMPETING BRAND
2. 60 MONTHS TO CONVERT COMPETING BRAND
3. DUALITY ON MERCHANT SIDE IS PERMITTED
4. AFTER ACQUISITION, 6 MONTHS TO CONVERT

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OPEN MEMBERSHIP

PRO

- SLIGHT LEGAL RISK
(NO DAMAGE LIABILITY)
- INCREASES VISA REVENUES BY
APPROXIMATELY \$ 100 MILLION PER YEAR
THEREBY MAINTAINING BRAND IMAGE
- MAINTAINS AND POSSIBLY ENHANCES MEMBER
MARKET SHARE AGAINST AMERICAN EXPRESS
AND DISCOVER

CON

- NEW ENTRANTS WILL COST EXISTING
MEMBERSHIP APPROXIMATELY
\$ 35 MILLION MORE PER YEAR IN PROFITS
THAN IF LIMITED TO MASTERCARD
- POSSIBLE REGULATION OR GOVERNMENT
INTERVENTION

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CLOSED MEMBERSHIP

PRO

- **ENHANCES MEMBER PROFITABILITY BY APPROXIMATELY \$ 35 MILLION PER YEAR UNLESS PREFERENCE FOR VISA DIMINISHES**
- **UNLIKELY GOVERNMENT REGULATION OR INTERVENTION**

CON

- **SIGNIFICANT LEGAL RISK**
- **LOSS OF VISA REVENUES OF APPROXIMATELY \$ 100 MILLION PER YEAR RESULTING IN HIGHER FEES TO MEMBERS OR DIMINISHED BRAND IMAGE**
- **LOSS OF ONE SHARE POINT TO AMERICAN EXPRESS OR DISCOVER EQUALS APPROXIMATELY \$ 55 MILLION PER YEAR**
- **PREFERENCE FOR VISA OVER MASTERCARD LIKELY TO DIMISH**

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CLOSED MEMBERSHIP WITH ROLL BACK

PRO

CON

- ENCHANCES MEMBER PROFITABILITY BY APPROXIMATELY \$ 15 MILLION PER YEAR
- FAVORABLE GOVERNMENT POSITION
- ENSURES MEMBER BRAND LOYALTY AND WILLINGNESS TO FUND BRAND IMAGE
- POTENTIAL FOR PREMIUM PRICING
- COULD ESTABLISH A TRUE BANKERS' BRAND
- SMALL LEGAL RISK
- DANGER OF BANKS SELECTING MASTERCARD
- LOSS OF REVENUES BY MEMBERS IN CONVERTING TO ONE BRAND
- DISRUPTION TO MEMBER PROGRAMS

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Overview

Objective: Project Economic Impact Of Open Vs. Restricted Membership On Visa Members And The Visa Organization

- Research Undertaken
- Assumptions And Research Implications
- Member Impact Of Open Membership
- Impact Of Restricting Membership On Visa
- Implications For Long Term Member Profitability

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Research Undertaken

- Visa Commissioned Survey Of AT&T Cardholders
 - Analysis Of Member Solicitation Results
 - PSI Annual Industry Survey
 - Analysis Of Potential Entrants
 - AT&T Experience To Date

Simplifying Assumptions

- Without Added New Entrants
 - Industry Growth Will Slow From 14% To 7%
 - Profit Margins Will Decline To 3.5% In 1991 And Continue To About 3% By 1995
- New Entrants
 - Will Use Free Cards As Initial Entry Strategy
 - Card Usage Will Reflect System Norms
 - Total Impact In 1995: 2.75 Times AT&T Results

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Research Implications

25% Of New Entrant Activity Will Be New To Visa And MasterCard

- 5-10% New To Industry
- 15-20% Displacement From Discover And Amex
- Denying New Entrants Access To Visa Will Save 5-10% Of Activity
- New Entrants Have The Potential To Accelerate Erosion Of Margins But No Evidence Of Ability To Achieve Premium Pricing For Visa

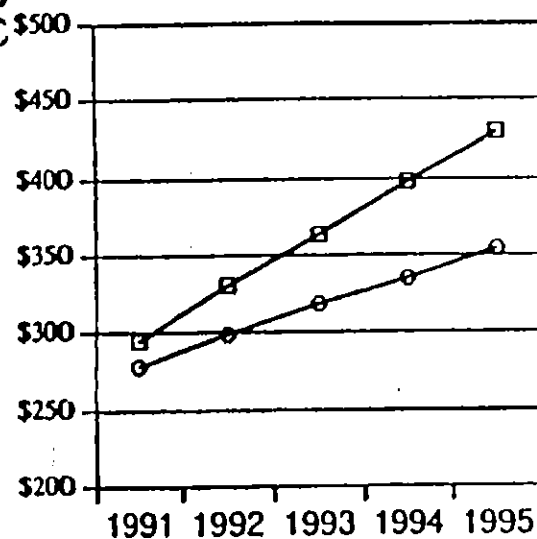
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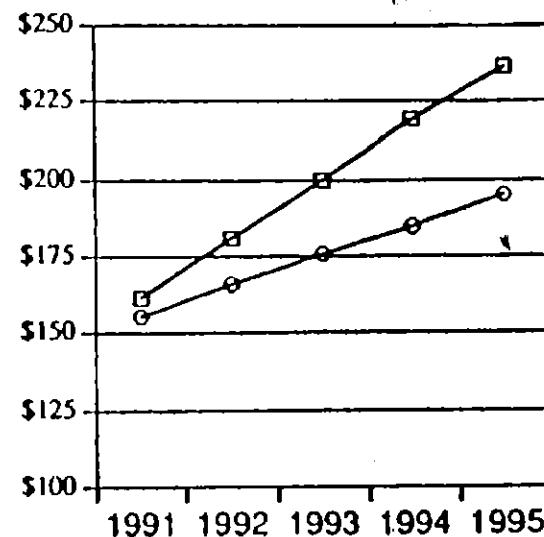
Member Impact Of Open Membership

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Volume (\$bil)



Outstandings (\$bil)



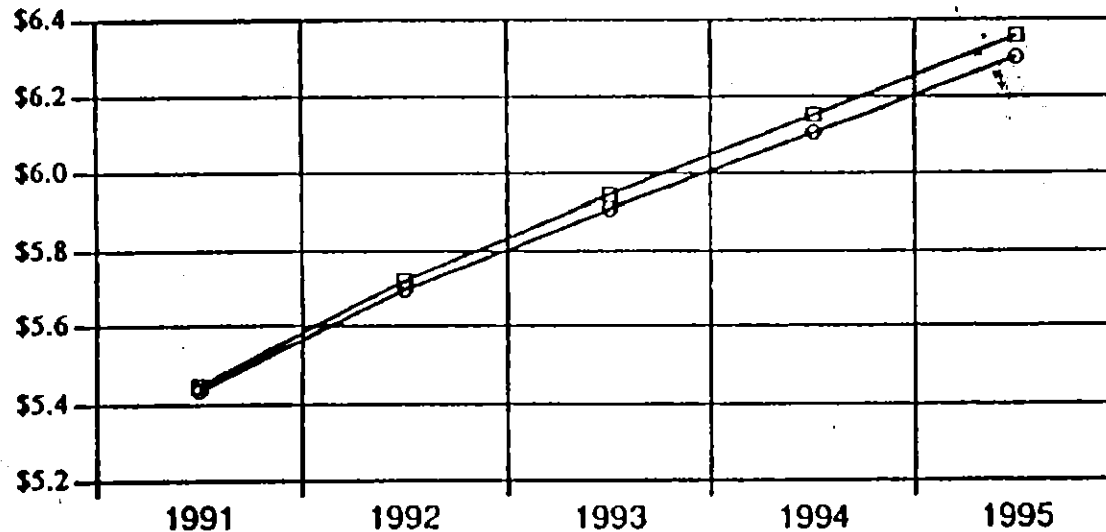
■ All Issuers - Total Visa & MasterCard

○ Existing Members - Total Visa & MasterCard

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Existing Member Profitability (\$ billions)



- Open Membership Continues
- Membership Restricted

Handwritten calculations and notes:

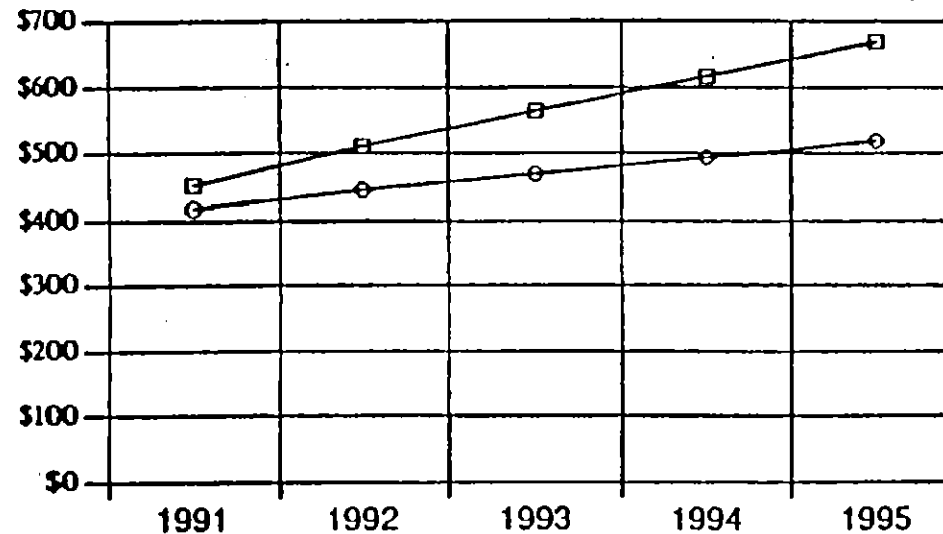
- $\frac{6.35}{430} = .0148$
- $\frac{6.3}{350} = .018$
- $\frac{6.35}{235} = .027$
- $\frac{6.3}{197} = .032$
- $\frac{1.84}{31} = .0594$
- $\frac{3.24}{31} = .1045$
- $\frac{2.74}{31} = .0884$
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Impact Of Closed Membership

Total Visa USA Revenue (millions)



Revenue
Decline
(%)

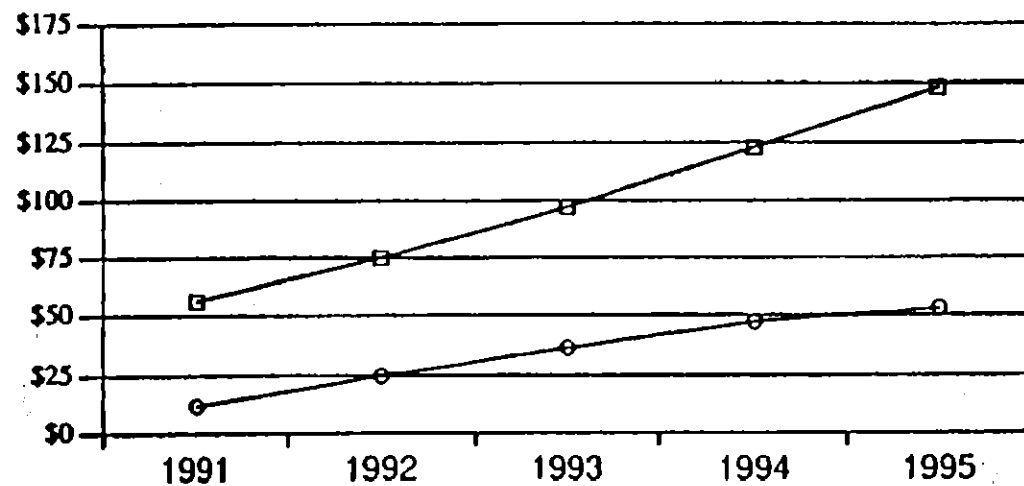
8% 13% 17% 20% 22%

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Impact Of Closed Membership

Visa Revenue Declines Much More Than Members Gain In Profits



- Visa Revenues Lost (millions)
- Member Profits Retained (millions)

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Member Costs Of A Weakened Visa

Preference For Visa Likely To Decline, Thereby
Shrinking The Value Of Closing Visa

Loss Of Share To Amex, Discover & JCB
Potentially Greater Than Added Loss To New
Entrants



Loss Of 1% Share
Costs Members
\$50-60 Million Per Year



Added Cost
Of Opening Visa
\$30-35 Million Per Year

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Potential Revenue Offsets

- Service Fee Increase From .069% to .11%
- Member Conversion Of MasterCard To Visa
 - Requires Conversion Of Over 50% Of Current MasterCard Plus Retention Of All Visa Business
- Even With Total Conversion, Added Marketing Efforts Could Require Increased Fees

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The Costs and Operating Requirements for a Successful Premium-Priced Visa are Probably Unacceptable to the Membership.

<u>Requirement</u>	<u>Member Impact</u>
<ul style="list-style-type: none">• Superior Product and Servicer Performance	<ul style="list-style-type: none">• Separate Visa/MC Operating Procedures• Possibly, Separate Visa/MC Customer Service Staff• Reduced Ability for Differentiation
<ul style="list-style-type: none">• Consistent Performance	<ul style="list-style-type: none">• Investment by Most Members OR Greater Centralization• Reduced Differentiation
<ul style="list-style-type: none">• Superior Image	<ul style="list-style-type: none">• Greater Investment in Brand Marketing Activities• Elimination of Member Activities Which Blur Visa/MC Identities• Higher Costs• Reduced Ability to Brand the Bank

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The Requirements for a Successful Premium-Priced Visa Are
Unlikely to be Met in an Environment of Duality

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- Visa Cannot Mandate Product/Service Superiority or Stronger Marketing Efforts
- Market Forces Encourage Brand Homogenization Among Dual Issuers:
 - Cost Efficiency Encourages Identical Operations
 - Competition Between Issuers Encourages Meeting Competitive Product/Service Quality Levels with Both Brands

Premium Pricing Is Unlikely to Become Universal

- New Visa/MasterCard Entrants Will Use Low-Price Entry Strategy
- Discover Continues Low-Price Strategy
- Premium Pricing Cannot be Mandated

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